

18 December 2006

Screening report

Croatia

Chapter 6 – Company Law

Date of screening meetings:

Explanatory meeting: 21 June 2006

Bilateral meeting: 19 July 2006

I. CHAPTER CONTENT

The chapter includes harmonised rules in the field of company law, including financial reporting requirements, intended to facilitate the exercise of the right of establishment.

In the field of **company law**, the first company law directive includes safeguards providing for mandatory disclosure requirements, limiting the grounds for invalidity of the obligations entered into by companies, as well as limiting the grounds for nullity of public and private limited liability companies. The eleventh company law directive similarly provides for disclosure requirements in respect of branches. The second company law directive contains rules on the formation of public limited liability companies and the maintenance and alteration of their capital.

The third and sixth company law directives harmonise national rules for the protection of shareholders and of creditors in the context of domestic mergers and divisions of public limited liability companies. The tenth company law directive provides for rules and procedures to facilitate cross-border mergers of public and private limited liability companies. The thirteenth company law directive on takeover bids lays down harmonised rules to facilitate cross-border takeovers within the EU, as well as improving transparency and protecting minority shareholders in the context of such takeovers.

The *acquis* also provides for certain European legal forms, in particular the European Economic Interest Group (EEIG) and the European Company (*Societas Europaea* or SE), while leaving several aspects of their internal structure and operation to be regulated through the domestic law of Member States. The twelfth company law directive requires Member States to ensure that their domestic law recognises single-member limited liability companies.

Two Commission recommendations address corporate governance principles about the remuneration of directors and about the independence of directors and committees of the supervisory board.

In the field of **accounting and auditing**, the *acquis* includes valuation rules and layouts for balance sheets and profit & loss accounts for annual (fourth company law directive) and consolidated (seventh company law directive) accounts of public and private limited liability companies. These directives also set-out audit requirements, as well as disclosure and publication obligations. In addition, a Regulation requires Community companies listed on a regulated market to draw-up their consolidated accounts in accordance with international accounting standards endorsed by the European Commission. Member States may extend the application of such international accounting standards to the consolidated accounts of non-listed companies and to annual accounts. Finally, the recently adopted eighth company law directive harmonises rules including *inter alia* the approval and registration of statutory auditors, external quality assurance, public oversight, auditor independence and the possible application of international standards of audit. Two Commission recommendations set out minimum standards for audit quality assurance and auditor independence.

II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Croatia and the discussion at the screening meeting. Croatia indicated that it can accept the *acquis* regarding company law. Croatia indicated that it does not expect any difficulties to implement the *acquis* by accession.

II.a. Company law

Company law in Croatia is governed primarily by the Companies Act, a statute largely modelled on German legislation. The act regulates different types of business forms (see below) and contains rules on groups of companies, mergers, divisions, transformations of companies and the legal status of foreign companies. The Companies Act was last amended in 2003 to reflect recent developments in German and European company law.

The Companies Act recognizes three principal types of business forms:

- sole traders;
- companies of persons: general partnerships, limited partnerships, economic interest groupings;
- companies of capital: public and private limited liability companies.

Croatian law refers to a public limited liability company as a "joint stock company" (*dioničko društvo* or d.d.) and to a private limited liability company as a "limited liability company" (*društvo s ograničenom odgovornošću* or d.o.o). It currently recognises only the dual structure of administration for public limited liability companies (separate management and supervisory boards).

The following table shows the number of companies and other business forms in each category registered in Croatia as of 30 June 2006.

ORGANISATIONAL FORM	NO. OF ENTITIES
PUBLIC LIMITED LIABILITY COMPANY	1 833
PRIVATE LIMITED LIABILITY COMPANY	109 804
ECONOMIC INTEREST GROUPING	72
GENERAL PARTNERSHIP	483
LIMITED PARTNERSHIP	89
SOLE TRADER	11

The **disclosure requirements, validity of obligations and grounds for nullity** for public and private limited liability companies are regulated by the Court Register Act (Official Gazette 1/95, 57/96, 1/98, 30/99, 45/99, 54/05), the Companies Act (OG 111/93, 34/99, 121/99, 52/00 and 118/03) and the Act on the Register of Annual Financial Reports (OG 47/03).

Croatian law requires all merchants (sole traders, companies of persons and companies of capital) to register in the court register. The establishment, organisation and administration of the register as well as the court registration procedures are governed by the Court Register Act. The form of the register and the methods of management and administration of the register are defined in bylaws issued by the Minister of Justice.

The register is kept by commercial courts. Registration is done with the commercial court having jurisdiction over the location of the company's seat. Company documents are kept in paper form, though the law provides that they may also be kept in electronic form. A separate file is kept for each company. Each company receives an identification number under which it is registered.

Croatian legislation provides for comprehensive requirements concerning the filing of information and documents pertaining to private and public limited liability companies with the court register. Anyone may inspect information entered in the court register, request an excerpt from the register or copies of the documents deposited in the register, without having to prove legitimate interest. The court register can be accessed for free via the Internet¹. A copy of the documents maintained in the register can be obtained against the payment of a stamp duty of HRK 5,00 per page (about €0,7 at the current exchange rate), while the production of a certified copy incurs a stamp duty of HRK 100 (less than €14 at the current exchange rate). Particular data entered into the court register are published in the official gazette.

The documents and particulars entered into the court register may be relied on by the company against third parties only after publication in the official gazette, unless the company proves that the third party had knowledge thereof. However, with regard to transactions taking place before the sixteenth day following the publication, the documents and particulars cannot be relied on by the company against third parties who prove that it was impossible for them to have had knowledge thereof.

Croatia reports that, following the launch of the HITRO.HR service² the time required to register a company has been substantially reduced to 1 day (SMEs) and to 3 days (private limited liability company). The HITRO.HR service is limited to the establishment of private limited liability companies.

Financial documents are filed in a separate register (Register of Annual Financial Reports) kept by the Financial Agency (FINA). All legal entities subject to profit tax, including public and private limited liability companies, have to file their financial reports with FINA. The register is public – any person may, without providing proof of legal interest, request information from the register, but no publication is foreseen. The register is accessible via the Internet subject to payment of an annual subscription fee. Documents kept in the register can be accessed at the premises of FINA (which has offices throughout the country). Excerpts from the register can be obtained for a fee of HRK 20 (less than €3 at the current exchange rate). Croatian law does not require the publication of financial reports filed with FINA, nor of the fact that they have been filed in the register, in the official gazette (see also under accounting in part II.b. below).

According to the statistics submitted by the Croatian authorities for 2005, 7373 companies did not file financial reports within the statutory deadline, while 10,043 did not file full financial reports. Overall, some 18,000 misdemeanour reports related to breaches of disclosure obligations in respect of financial reports have been submitted to the Ministry of Finance by FINA.

The Companies Act stipulates that letters and other forms of the company must indicate the company name, legal form and seat; the register in which the company's file is kept; the number of the company in that register; and the name and seat of the legal person at which the company account is kept and the number of that account.

Croatian law regulates the validity of obligations entered by or on behalf of the company both before and after its registration. The founders and person(s) who assumed obligations on behalf of the company prior to its registration are jointly and severally liable with all their

1 <https://sudreg.pravosudje.hr/SUDREG3/SudregController>

2 HITRO.HR (<http://www.hitro.hr/>) is a service of the Government of Republic of Croatia intended for quick communication of citizens and business subjects with the state administration. One of its services is intended to facilitate and accelerate the establishment of private limited liability companies.

assets. After registration, the company is represented by the management board. The management board is authorized to take all legal acts of representation in business, before the courts and other governmental bodies.

If the management board consists of several persons and the articles of association have not provided otherwise, its members are authorized to represent the company only jointly. The articles of association of the company may determine whether individual members of the management board shall be authorized to represent the company independently or jointly. The authority of the management board to represent the company may not be restricted.

In relation to the company, the members of the management board shall comply with the restrictions lawfully imposed on them by the articles of association, decisions of the supervisory board, general meeting and the rules of procedure of the management board. These restrictions may never be relied on against third parties, even if they have been disclosed. Croatian law does not incorporate an *ultra vires* doctrine.

The nullity of a company may only be pronounced by a Court. An action seeking a declaration of nullity may be initiated by each shareholder and by each management or supervisory board member within three years from the date of the company's registration.

Croatian legislation recognises only three grounds for nullity:

- the articles of association of the company or the statement on acquisition of shares do not state the name of the company, the amount of share capital, contributions to the company or the company's objects;
- the provisions on the company's objects are null and void;
- the rules governing the minimum required share payments and the conditions and procedures for registration in the court register have not been complied with.

The declaration of nullity results in the compulsory liquidation of the company, but it does not affect the validity of obligations previously undertaken by or on behalf of the company. Upon the declaration of a company's nullity, shareholders who have not made payments in full for the shares shall do so to the extent necessary to settle the obligations of the company.

Croatia considers that its legislation is partially aligned with the 1st Company Law Directive but acknowledges that some provisions are not aligned with this Directive, in particular concerning the disclosure and publication of financial reports; and the access to the court registers by electronic means.

Croatia intends to fully align its legislation with this Directive through the adoption of amendments to the Court Register Act planned in the last quarter of 2006 and amendments to the Companies Act planned in the first quarter of 2008. Croatia estimates that the implementation of a technical framework for electronic access to court registers will require significant financial resources.

As regards **disclosure requirements in respect of branches**, the legal framework described above for disclosure in respect of public and private limited liability companies applies. Croatian law applies the same disclosure requirements to branches set up by a company established in EEA States and to branches set up by a company established in a third country.

A court may deny registration to the branch of a foreign company if there is no proof that:

- the company is duly registered and undertakes regular activities in the place of incorporation. During the screening meeting, the Croatian delegation stated that, in practice, proof of incorporation is deemed to provide proof of activity, but showed willingness to amend the relevant provisions if necessary, notably in order to comply with the Centros jurisprudence;
- the founder has not appointed an authorised person domiciled in Croatia responsible to carry out activities of the branch in Croatia. Croatia acknowledged that this provision is incompatible with the *acquis* and intends to abolish it;
- reciprocity exists. Croatia stated that reciprocity is presumed, the Ministry of Justice can allow registration even if there is no evidence, while this requirement is in practice not applied to WTO members. Croatia in any case recognises that this provision is incompatible with the *acquis* and intends to abolish it.

Croatia states that it intends to align its legislation with the 11th Company Law Directive by amending the Act on Court Register in the last quarter of 2006 and the Companies Act in the first quarter of 2008.

Croatian legislation provides that both private and public limited liability companies may be a **single member company**. A single member company can arise either by formation or by acquisition of all shares. Croatia has not used an option left to the Member States, as defined in Article 2 paragraph 2 of the 12th Company Law Directive.

The following shall be registered into the commercial register:

- if the sole member is a natural person: the name and surname, place of residence, date of birth, the number and designation of the personal identification document, and for foreign citizens, the country which issued that document;
- if the sole member is a legal person: the company name, seat and its registration number, or the appropriate data in the case of foreign legal person.

The application for entry into the commercial register of the sole founder shall be filed if the sole founder offers appropriate security that his (capital) cash contribution shall be paid in an orderly manner.

Should all the shares in the company be consolidated with one company member within three years of entry of the company in the commercial register, such member shall within the following three months make full payment for the cash contributions, provide the company with security for the outstanding amount or transfer part of the shares to a third party. The management board of the company shall file the application for entry of the consolidation of shares in the commercial register with the register court.

If the sole member fails to fulfil his duty and does not file an appeal against the register court order within the given time, the register court shall issue a decision on dissolution of the company.

For private limited liability companies, the sole member exercises the powers of the General Meeting. Decisions taken by the sole member in a general meeting shall be recorded in minutes and signed by the sole member or, in the case of a public limited liability company, recorded in the minutes taken by the notary public.

Legal transactions between the sole member and the company, in which the sole member represents the company, may be concluded only with special authorization from the company, even when the sole member is not the only member of the management board.

These transactions shall be concluded in writing. However, the written form shall not be necessary in case of habitual business transactions of the company concluded under the usual conditions.

Croatia considers that its legislation is fully aligned with the 12th Company Law Directive.

The Companies Act regulates **capital formation, maintenance and alteration of public limited liability companies**. The minimum capital requirement for a public limited liability company is HRK 200.000 (about €27.500 at the current exchange rate).

Shares may be issued for cash and non-cash consideration, but not against an undertaking to provide services. Shares issued for a consideration in cash must be paid up at the time the company is incorporated at not less than 25% of, as the case may be, their nominal value or accounting par value. Non-cash consideration must be assessed by an independent auditor and it must be transferred in full within five years of the company's registration.

Net profits may be distributed to the shareholders after allocation for the following purposes:

1. to cover losses brought forward from previous years;
2. to distribute them into statutory reserves;
3. to distribute them into reserves for own shares, if the company has acquired or intends to acquire them;
4. to distribute them into reserves provided for by the articles of association, if the company has formed them.

However, unless the registered capital is reduced, dividends may not be paid out if the company's net assets during the previous fiscal year are below the registered capital amount, plus the amount of reserves that cannot be paid out to shareholders, under the provisions of the law or articles of association, or if they would fall below the registered capital amount as a result of such payment. Distributions made contrary to these provisions must be returned by shareholders who have received them if the company proves that these shareholders knew or ought to have known of the irregularity.

Shares of the company may not be subscribed for by the company itself. If the shares of a company have been subscribed for by a person acting in his own name but on behalf of the company, the subscriber shall be deemed to have subscribed the shares for his or her own account.

A company may not acquire its own shares except in seven cases explicitly provided for and under the conditions specified in the Companies Act. Acquisition is allowed only when the company has already ensured reserves for these shares as required by law without reducing the share capital of the company, or statutory reserves or reserves established by the articles of association of the company which are not meant for payments to shareholders.

If the company's capital relating to the shares acquired by the company lawfully exceeds 10% of the share capital of the company, the company must, within three years following the acquisition of shares, alienate the portion of the shares exceeding the aforesaid percentage. If the company's own shares are not alienated within this time limit, the company shall withdraw them. A company may not advance funds, grant loans nor provide security with a view to the acquisition of its shares by a third party. Such legal transactions are null and void.

Any increase in the company's registered capital must be decided upon by the general meeting by a majority of at least three-fourths of the share capital represented at the general meeting at the time of the adoption of the decision on the share capital increase. The company's articles of association may provide for a different majority. There shall be a separate vote for each class of shareholders. By way of exception, the articles of association may authorize an increase in capital up to half of the subscribed capital by the management board, with the prior consent of supervisory board.

The compulsory withdrawal of shares is permitted subject to conditions.

Croatia considers that its legislation is in line with the 2nd Company Law Directive.

Domestic mergers of public limited liability companies are regulated by the Companies Act and the Labour Act. The Companies Act recognises merger by acquisition of one or more companies by another and merger by formation of a new company.

The merger agreement is negotiated by the respective management boards and is concluded in the form of a notarial deed. The merger agreement shall be filed with the relevant commercial register and must contain a comprehensive range of information.

Auditors appointed by the relevant commercial courts are required to prepare a written report about the merger agreement. A joint report may be prepared. The report shall be concluded by a statement regarding the adequacy of the ratio of the proposed exchange of shares.

The management board of each company participating in the merger must prepare a merger report containing the draft terms of the merger. This must contain at least the following elements:

- a legal and economic explanation of the agreement;
- the share exchange ratio;
- the amount of cash payments;
- the standards used for the evaluation of assets;
- any special difficulties encountered in the appraisal of the company's value.

Shareholders' right to access merger documentation includes an entitlement to early access to the merger documentation (one month before the general meeting); the right to prompt receipt, free of charge, of a transcript or copy of all relevant merger documents; and the right to receive, at the general meeting, notification of any facts pertaining to the other companies participating in the merger.

The merger agreement shall be effective when approved by the general meetings of all companies participating in the merger. Approval by the general meeting of the acquiring company is not required if the acquiring company holds shares representing 90% or more of the merged company's share capital, except if such decision is requested by shareholders holding at least 5% of the share capital. If the acquiring company holds all shares of the company being merged, neither information on the exchange of shares nor an audit report shall be required.

Croatia considers that the protection of the rights of the employees of each of the merging companies is aligned with Directive 77/187/EEC (see also chapter 19 – Social policy and employment).

A guarantee shall be provided to creditors of companies participating in the merger if they have filed their request for such a guarantee within six months following the publication of entry of the merger in the same commercial register in which the company of which they are creditors is entered. The claims of creditors are not due. The right to request such a guarantee shall belong to creditors of the transferee company only if they can prove that the merger constitutes a threat to the satisfaction of their claims. The publication of entry of the merger shall include a statement reminding the creditors of such right. Holders of tradable bonds, variable interest bonds and certificates of special rights to dividend are granted the same rights they had in the merged companies.

The application for registration of the merger must be submitted to the court of registration by all companies. The merger may be entered into this register only after it has been entered in the register where the transferor company is registered. The acquiring company's court must officially notify the court of each merged company about the merger registration date.

The merger is deemed completed on the date that it is entered into the acquiring company's court register. Registration of the merger has the following effects:

- the assets and liabilities of the merged company are transferred to the acquiring company (special rules if unjust liabilities burden the acquiring company);
- the merged companies cease to exist;
- the shareholders of the merged company will become shareholders of the acquiring company unless:
 - a) the acquiring company holds shares of the merged company;
 - b) if the merged company holds its own shares;
 - c) a third party holds the merged company's shares on its behalf.

Members of the management and supervisory boards of the companies being acquired are jointly severally liable for the damage the merger has caused to the company, its shareholders and creditors of the company. Members of such bodies who, during audit of company's assets and the conclusion of the merger agreement, have acted with due care, are exempted from such liability.

After the entry of the merger into the commercial register of the acquiring company, an action to declare nullity of the decision on merger made by the acquired company may only be filed against the acquiring company. Moreover, deficiencies in the merger procedure shall not affect the validity of the merger after the entry of the merger into the commercial register of the acquiring company. The Act on Commercial Register provides that nullification procedures may be initiated up to three years after the merger (contrary to 3rd Company Law Directive which provides a 6 months deadline).

The abovementioned requirements apply *mutatis mutandis* to a merger by the establishment of a new company. In addition, the articles of association and members of the supervisory board of the new company must be approved by the general meeting of the merging companies. A merger may only be decided if each merging company has been registered for at least two years.

The Companies Act lays down special rules applicable to the merger and consolidation of two or more private limited liability companies and to the merger and consolidation of a public limited liability company and a private limited liability company and *vice versa*.

Domestic divisions of public limited companies are regulated by Companies Act and the Labour Act. Croatian law foresees two forms of division:

1. Division by separation (the company divided ceases to exist):
 - by formation of new companies;
 - by acquisition.
2. Division by split-off (the company divided continues to exist):
 - by formation of new company(ies);
 - by acquisition.

Croatian legislation also covers divisions of private limited liability companies.

The rules applicable to the preparation of the division plan, the division report by management and the audit report mirror those applicable to the analogous documents in the event of a merger (see above). The division plan must be published one month before convening the general meeting of the company being divided which is to decide on the division plan and must be approved by a resolution of the general meeting of the company being divided. A report by the supervisory board of the company being divided, verifying the division plan and audit of the division plan is provided for the general meeting of the company being divided.

The abovementioned reports by management, the auditors and the supervisory board are not required if a general meeting, at which all shareholders of the company being divided must participate, adopts a unanimous resolution to the effect that the relevant body(ies) and/or auditors of division are relieved from their respective duty(ies) to prepare such report(s).

The rights of shareholders and of employees in the event of a division mirror those that apply for mergers (see above).

The Companies Act provides for creditor protection rules in the event of a division:

1. all participating companies, including the company to which the respective obligations have been transferred in accordance with the division plan, shall be jointly and severally liable for all obligations of the company being divided until the division is entered in the court register, with the liability limited up to the value of assets transferred to each participating company and reduced by the liabilities incurred by each of them, all in accordance with the division plan;
2. creditors of the company being divided with claims not yet fallen due at the time of entry of division in the court register, shall be granted security by the participating companies if they have reported their claims within six months of publication of the entry of the division in the court register (excluding creditors fully secured by the right of separate satisfaction and creditors having the priority of satisfaction in bankruptcy proceedings). Creditors to which such security is granted may not call upon joint and several liability of the participating companies;
3. holders of convertible bonds, bonds with the right to dividend payments, bonds with the rights of subscription of shares, as well as others having such rights or the rights in participation of profit of the company being divided shall be entitled to adequate compensation in cash, unless they have received such equal rights in the newly formed companies, or received such rights by one of the new companies at a later point.

The provisions which regulate division by formation of new companies shall apply *mutatis mutandis* in respect of division by acquisition with exceptions that the division plan is replaced by a contract on division and acquisition to be executed by the management boards of the company being divided and the acquiring company in the form of a notarial deed; and that, if the share capital of the company being divided is reduced or that of the acquiring

company is increased in the procedure of split-off by acquisition, the relevant provisions which regulate mergers shall apply *mutatis mutandis*.

Croatia considers that the Companies Act is partially aligned with the 3rd and 6th Company Law Directives, but acknowledged some gaps including the abovementioned deadline for the application of a declaration for nullity of a merger; provisions regulating certain aspects in connection with division by acquisition; the fact that auditors of a division are appointed by the supervisory board of the respective company and not by a judicial or administrative authority; and the fact that entry of the division in the court register has to be submitted by all members of management board and supervisory board of all companies involved in a division, and not by all members of such bodies of only one company involved in a division/recipient.

Croatia intends to align its legislation with the 3rd and 6th Company Law Directives by amending the Companies Act in the first quarter of 2008.

There are no provisions in Croatian law concerning **cross-border mergers**. Croatia does not expect any problems to transpose the 10th Company Law Directive as Croatian law already provides for domestic mergers between private and public limited liability companies. Amendments to the Companies Act will be adopted in first quarter of 2008.

Take-over bids are regulated by the Companies Act, the Act on Takeover of Joint Stock Companies (the Takeover Act) and the Securities Market Act. Others relevant legislation includes the Labour Act, the Act on Croatian National Bank (HNB), the Act on the Croatian Agency for Supervision of Financial Services (HANFA). The latter two apply in relation to the take-over of financial institutions supervised by these authorities.

The Takeover Act regulates the conditions for submitting bids for the takeover of joint stock companies – the issuers, the takeover procedure, rights and obligations of participants in the takeover procedure, and supervision over the takeover of joint stock companies.

“Issuer” means a joint stock company that fulfils one of the following criteria pursuant to the Securities Market Law:

- a company issuing shares in an initial public offering;
- a company having more than 100 shareholders and the share capital that amounts to at least HRK 30.000.000,00 (about €4,100,000 at the current exchange rate).

Any person satisfying one of the following conditions is obliged to publish a takeover bid:

- a person who acquires shares which, together with the shares that he already possesses, exceed a threshold of 25% of the total number of votes accorded by the issuer's shares carrying voting rights;
- a person who, having acquired less than 75% of the voting shares pursuant to a takeover bid, subsequently acquires further shares of the same issuer;
- a person who, having acquired 75% or more of the voting shares pursuant to a takeover bid, subsequently acquires an additional 5% of the voting shares or subsequently acquires further shares, regardless of the amount, 18 months following the day of the actual acquisition of shares after a previous takeover bid.

Some transitional provisions are still applicable to certain situations in which shareholders with voting shares in excess of certain thresholds on the date of the entry into force of the Takeover Act subsequently acquire additional voting shares in the same issuer.

An exemption from the obligation to publish a takeover bid exists only in a limited number of cases listed in the Takeover Act, such as the acquisition of shares by inheritance, marital acquisition, etc. The supervisory authority does not have the possibility to introduce nor to allow further exceptions.

The Takeover Act regulates the actions of concert parties, the assurance of assets (e.g. bank guarantee) and the agreement on the deposit of shares. The latter must be concluded prior to filing a request for the approval to publish a takeover bid with HANFA.

The Takeover Act foresees the principle of the offeree's board neutrality. After notification on the acquisition of shares or of the intention to publish a takeover bid and until the finalisation of the takeover bid, the offeree company's management board:

- cannot exercise its statutory authorisation to increase the issuer's initial capital by issuing new shares until the expiration of the takeover bid validity period and the payment term, or until the expiration of the publication deadline for the takeover bid if the latter has not been published;
- must not make a decision on extraordinary business operations that could significantly change the balance of the company's assets or liabilities;
- must not, without a prior approval of the general assembly, make a decision on the company's acquisition or alienation of its own shares;
- shall notify the issuer's employees of the takeover bid.

The supervisory board is obliged to issue a substantiated opinion within seven days of the publication of the takeover bid, with particular emphasis on the price per share, the offeror's intentions regarding the company that is being taken over and the offeror's objectives regarding the company that is being taken over. The members of offeree's management and supervisory boards may not take any other action that may lead to any influence on the takeover bid.

The Takeover Act regulates the mandatory content of a takeover bid, although Croatia acknowledges some discrepancies with the *acquis*.

The application for the approval to publish a takeover bid, the bid and respective documents must be submitted within 30 days after the obligation to publish a takeover bid has arisen. The bid shall be valid for 30 days after its publication. In the case when competing takeover bids are published, the offeror may extend this deadline until the expiration of the deadline of such competing bids. In case of modifications the entire bid validity period may not exceed 60 days, except if it has been extended due to the publication of competing bids. The bid must be published in the official gazette and in one daily newspaper.

The offeror cannot impose any conditions on the obligation to purchase of the shares subject to the takeover bid (exceptions: exclusion of encumbered shares or limitation of deposited shares at 50% of voting rights). If the shareholder has deposited the shares in accordance with the conditions set out in the takeover bid, the acceptance of the takeover bid and the offeror's obligation to pay the price of the deposited shares shall become effective after the expiration of the bid validity period. A takeover report has to be published within 7 days after the expiration of the takeover bid period and after the expiration of the payment term.

After the offeror has published a takeover bid, third parties are not allowed to publish their intention to acquire or alienate the issuer's shares in the media or electronic media accessible to the public, except by means of a competing takeover bid.

As of the date when the obligation to publish a takeover bid has arisen until its publication, that is, as of the publication of the bid until the expiration of the bid validity period, the offeror may neither:

- acquire the shares carrying voting rights that are the subject of the bid, nor undertake to acquire such shares in any other way than on the basis of a takeover bid;
- alienate nor undertake to alienate the shares carrying voting rights at the issuer's general assembly.

The Takeover Act regulated the offer price, which may not be lower than the highest price at which the offeror or the person that acts in concert with it, has acquired shares carrying voting rights in a period of one year prior to the date of publication of the takeover bid. Moreover, if the offered price is lower than the average price achieved on the stock exchange or regulated public market, the offeror must offer at least the average price achieved on the stock exchange or regulated public market.

Croatia considers that its legislation is partially aligned with the 13th Company Law Directive. The main differences between the directive and the Takeover Act highlighted by Croatia include the absence of an explicit provision to exclude investment funds from the obligation to publish a takeover bid; the need to adjust disclosure requirements and the rules concerning board neutrality; the fact that the competent authority cannot adjust the offer price, e.g. in cases of market manipulation; the need to introduce sell-out and squeeze out rights (the latter exists within the Companies Act but not within takeover procedure as a separate possibility); and the absence of breakthrough rules. Croatia intends to align its legislation with the 13th Company Law directive through the adoption of a new Takeover Act in the third quarter of 2008.

There is no provision equivalent to the **Statute for a European company** (*Societas Europaea* or SE) in Croatian law. However, Croatia considers that there is no obstacle for Croatia to ensure that the provisions applicable to SEs do not result either in discrimination arising out of unjustified different treatment of SEs compared with public limited-liability companies or in disproportionate restrictions on the formation of a SE or on the transfer of its registered office. Croatia does not expect any difficulties to ensure the recognition of both the monist and dual forms of administrative structures.

Croatia intends to introduce the changes necessary to allow for the recognition of SEs through the adoption of amendments to the Court Register Act planned in the last quarter of 2006 and amendments to the Companies Act planned in the first quarter of 2008.

The Companies Act and the Court Register Act regulate **economic interest groups** (EIGs). The provisions regulating general partnerships apply unless otherwise specified. As of 30 June 2006, 72 EIGs were in existence in Croatia.

The definition of an EIG under Croatian law is similar to that of an European Economic Interest Group (EEIG) under the *acquis*. Members of EIGs under Croatian law are widely construed, including foreign natural or legal persons. No share capital is required and membership rights may not take the form of securities. Members have unlimited liability.

Croatia considers that the concept of an EIG is familiar in Croatia, but amendments to the Companies Act and Court Register Act (for deadlines see above) will be necessary to enable registration and functioning of EEIGs.

The **remuneration of directors** and the **independence of directors and the committees of the supervisory board** are regulated by the Companies Act and the draft Croatian code of corporate governance. The latter is based on the OECD corporate governance principles and uses a “comply or explain” approach. The Companies Act requires that the management and supervisory boards of listed companies shall on an annual basis make a statement that they have acted in accordance with the recommendations published in the Corporate Governance Code and that they shall continue to use such as guidance. Such a statement shall be permanently available to the company’s shareholders. It is expected that it will be published or publicly available.

Pursuant to the Companies Act, the remuneration of management board members is determined by the supervisory board, while that of supervisory board members may be determined by the articles of association or by a decision of the general meeting. Remuneration must be proportionate to the work carried out by the board member and to the condition of the company. In case of material deterioration of the condition of the company, remuneration of the management board member may be reduced by the supervisory board or, in certain circumstances, by a court of law.

The draft code of corporate governance provides for rules on the structure and methods of determining the remuneration of management and supervisory board members. Detailed information on remuneration of each management or supervisory board member, including the structure of remuneration, must be publicly disclosed. The supervisory board must establish a remuneration committee, which proposes the remuneration of management board members. Neither the Companies Act nor the Code foresee a remuneration policy statement (criteria, calculation of bonuses, etc.).

The supervisory board may set up committees to prepare decisions of the board and to control their implementation. The Code of Corporate Governance requires companies to establish an audit committee and a remuneration committee. Pursuant to the code, a director cannot be a member of the management and supervisory boards of same company, and cannot cumulate more than 10 supervisory directorships.

Pursuant to the Audit Act, all listed companies must establish audit committees. At least one member of the audit committee must be competent in accountancy and/or audit. The competencies of the audit committee include monitoring the financial reporting procedure, the internal control system, internal audit and risk management; supervising the audit of annual financial and consolidated statements; and giving recommendations to the general meeting on the appointment of an independent auditor or audit firm.

According to the Code of Corporate Governance, the supervisory board should consist mainly of independent members – independence is defined in detail in the code. The Code foresees rules on conflicts of interest. There are no rules about participation/membership of independent directors in committees, but the code suggests that they should be independent «where practicable».

Sanctions for non-compliance with legal provisions, e.g. requirement to establish audit committee, consist of misdemeanours (administrative fines).

Croatia considers that most of the general principles enshrined in the recommendations are reflected in the Croatian law or in the Code of Corporate Governance, but acknowledges that these do not provide for rules as detailed as those contained in the recommendations.

II.b. Corporate accounting and auditing

The current Accounting Act (Official Gazette 146/05) was adopted in 2005 and entered into force on 1 January 2006. The Croatian Financial Reporting Standards Board (FRSB), established in March 2006 pursuant to the new Accounting Act, has adopted two decisions, respectively concerning the promulgation of national accounting standards (see below) and concerning the translation and application of International Financial Reporting Standards or IFRS (both published in OG 61/2006). The latter provides for the translation and issuance of the international accounting standards adopted until 2004, including interpretations up to 31 March 2004. These standards were translated and issued by the Croatian Society of Accountants and Financial Experts in 2005 but they have not been published in the Official Gazette as a licence with the International Accounting Standards Board could not be concluded in time.

The **annual accounts** of private and public limited liability companies, are regulated by the Accounting Law and the two abovementioned Decisions of the FRSB. Small and Medium-sized Enterprises (SMEs) are required to report in accordance with national standards based on International Accounting Standards (IAS) adopted up to 2000. SMEs may also apply current international accounting standards, i.e. full IFRS. There are no possibilities for simplified or abridged accounting requirements for SMEs. Large enterprises, the definition of which also includes companies listed on a regulated market and financial institutions, are required to draw-up their accounts in accordance with full IFRS. The classification criteria (thresholds) used to define SMEs are in line with those set out in the 4th Company Law Directive.

The Accounting Act does not contain requirements concerning the layout of the balance sheet or of the profit and loss account, which is therefore regulated by IAS 1 – *Presentation of Financial Statements* (2000 version in the case of SMEs). Pursuant to the Audit Act, all companies with a turnover exceeding 30 million Kuna (about €4.1 million at the current exchange rate) are required to have their annual accounts audited. Moreover, the annual accounts of affiliated companies, regardless of their size, must be audited if their controlling company is subject to audit.

The Companies Act requires the preparation of an annual report but the content thereof is not prescribed in detail. Pursuant to the Accounting Act, only public limited liability companies are required to publish their financial statements (comprising the balance sheet; the profit and loss account; the cash flow statement; a statement on equity capital movements; and notes to the financial statements) but not the annual report. Moreover, the Act does not specify publication deadlines.

Croatia intends to align its legislation with the 4th Company Law Directive at the latest during the third quarter of 2007.

The **consolidated accounts** of groups of companies are regulated by the Accounting Act to a limited extent. The Act stipulates that any entity required to prepare consolidated accounts shall do so in accordance with international accounting standards, i.e. full IFRS. However, the Accounting Act does not include consolidation criteria nor exemptions for small groups. There is no requirement to publish consolidated accounts.

Croatia intends to align its legislation with the 7th Company Law Directive at the latest during the third quarter of 2007.

Croatian accounting rules have relied on **international accounting standards** since the adoption of the Accounting Act in 1992, according to which all companies had to apply international accounting standards. However, international accounting standards adopted after 2000 have not been published in the Croatian Official Gazette. As stated above, pursuant to the new Accounting Act, all “large” companies, listed companies and financial institutions are required to prepare their annual and consolidated accounts in accordance with international accounting standards. Croatia announced the intention to publish the latest version of IAS/IFRS during the autumn of 2007.

The FRSB’s Accounting Standards Committee is responsible for approving, translating, interpreting and publishing international accounting standards. Croatia acknowledged that issuing national interpretations is incompatible with the acquis.

Statutory audits are regulated by the Audit Act (OG 146/2005), which entered into force on 20 December 2005, and by the Statute of the Croatian Chamber of Auditors, which is established pursuant to the Act.

Statutory audits may only be performed by certified auditors who have been approved by the Chamber of Auditors. In order to be certified, an auditor must meet *inter alia* minimum educational, professional experience and good repute requirements, and must also demonstrate fluent knowledge of the Croatian language (spoken and written). The certified auditor may be a Croatian citizen or a foreign citizen whose foreign qualification as a certified auditor has been recognised by the Chamber. The examination programme must be approved by the Ministry of Finance. The Chamber maintains a register of certified auditors.

After passing the exam administered by the Chamber, certified auditors must enrol in a continuing professional education programme.

The Audit Act lays down requirements concerning auditor independence and the avoidance of conflicts of interest. It prohibits the provision of advisory services to the auditor's client during the same business year whose books are subject to audit. It further prohibits such services being provided by “related” audit companies/firms to the client or its related companies, and therefore has extra-territorial effect. The Act requires auditors to comply with a code of professional ethics. The Chamber intends to translate and adopt the IFAC Code of Ethics. Audit firm rotation (every four years) in the banking sector is governed by Banking Act.

The Ministry of Finance carries out public oversight of the Chamber’s activities, while the Chamber carries out the regulation of independent auditors and audit firms, including quality assurance reviews of independent auditors and audit firms (at least once every six years in general and 3 years with respect to public interest entities).

The Croatian Chamber of Auditors was established in March 2006 pursuant to the Audit Act. It is financed by fees and other revenue, such as the sale of publications and the organisation of seminars. The Chamber has a wide range of powers and responsibilities, *inter alia* issuing certified auditor certificates; granting and withdrawing operating licenses for independent auditors and audit firms; keeping the register of certified auditors and registers of independent auditors, joint audit offices and audit firms; translating and publishing the International Standards on Auditing and giving opinions on such Standards; proposing the program of audit examinations; organising professional education and

certified auditor examinations; and adopting the code of professional ethics for auditing profession.

The Chamber also sets the minimum requirements for performing quality control of audits carried out by audit firms, independent auditors and certified auditors; and supervises the work and control the quality of audits carried out by audit firms, independent auditors and certified auditors, take disciplinary actions, where necessary, and shall take the appropriate measures for the elimination and sanctioning of the established irregularities, of which it shall notify the Ministry of Finance every six months.

There are currently 1370 certified auditors and 360 audit firms in Croatia.

Public interest entities (listed companies, financial institutions, companies of special state interest) are required to set-up an audit committee, at least one of whose members must be competent in the area of accountancy and/or audit.

Croatia intends to align the Audit Act with the 8th Company Law Directive by adopting amendments in the first half of 2008.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

Overall, Croatia's legislation has reached a good level of alignment to the *acquis* covered by this chapter. Croatia presented reasonable plans for the alignment of its legislation to the *acquis* in all areas covered by this chapter.

The legislation in the area of company law has already reached a high level of alignment with the *acquis*. The key aspect of the *acquis* that is not currently incorporated in Croatian law is the concept of cross-border mergers. Moreover, other important adjustments are required concerning the disclosure and publication of financial reports, certain provisions concerning the registration of branches of foreign companies, procedural aspects relating to domestic mergers and divisions, the recognition of the *Societas Europaea* and the European Economic Interest Grouping and a number of aspects relating to takeover bids.

The legislation in the area of accounting and auditing is partially aligned with the *acquis*. Several important elements of the *acquis* remain to be incorporated in Croatian law. These include measurement and recognition requirements, obligations concerning the preparation of consolidated accounts, the audit scope for annual accounts, the publication of the reports of private limited liability companies, requirements concerning the authorisation of statutory auditors, external quality assurance of audit activities and the public oversight of the audit profession

III.a. Company law

Croatian has reached a good level of alignment with the 1st Company Law Directive related to the **disclosure requirements, validity of obligations and grounds for nullity** of public and private limited liability companies. Some adjustment will be necessary, in particular concerning the disclosure and publication of financial reports; and the access to the company registers by electronic means. The Companies Act has reached a good level of alignment with the 11th Company Law Directive concerning **disclosure in respect of branches**. Some adjustment will be necessary, mainly to repeal certain grounds on which the courts may refuse to register a branch. The Act has reached a high level of alignment with 12th Company Law Directive on **single-member companies**.

Croatian legislation has reached a good level of alignment with the 3rd Company Law Directive on **domestic mergers of public limited liability companies** and with the 6th Company Law Directive on **domestic divisions of public limited liability companies**. Some adjustments will be necessary to address the gaps described in section II.a.

Croatia will need to introduce provisions concerning **cross-border mergers**, but this should not be problematic given the existing provisions concerning domestic mergers of public and private limited liability companies.

The Takeover Act has reached a satisfactory level of alignment with the 13th Company Law Directive on **take-over bids**. Several adjustments will be necessary to address the gaps described in section II.a.

Croatia should not have any problems to allow the recognition of the **statute for a European company** nor of **European economic interest groups** in its domestic law.

Croatian legislation and the draft Code of Corporate Governance provide for most of the principles foreseen in the Recommendations concerning the **remuneration of directors** and the **independence of directors and the committees of the supervisory board**.

III.b. Corporate accounting and auditing

Croatian legislation is partially aligned with the 4th Company Law Directive on **annual accounts** and has reached a reasonable level of alignment with the 7th Company Law Directive on **consolidated accounts**. In both cases, several clarifications are necessary concerning measurement and recognition, layout requirements, audit scope and publication.

Due to Croatia's long-standing use of **international accounting standards**, no obstacles to the implementation of the IAS Regulation are expected. However, some provisions of the Accounting Act will need to be adjusted or repealed, notably to ensure that no national interpretations are issued.

The Audit Act is partially aligned with the 8th Company Law Directive on **statutory audits**. Changes will be required to transpose requirements of the Directive, notably organising an effective system of public oversight for statutory auditors and audit firms, respecting the principle of home country regulation and oversight by the Member State in which statutory auditor or audit firm is approved and the audited entity has its registered office. Moreover, certain discriminatory nationality and language requirements related to auditor certification will need to be repealed.